STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	**01-0701**
Illinois Power Company	:	
	:	
Reconciliation of revenues collected	:	
under gas adjustment charges with	:	
actual costs prudently incurred.	:	

REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Illinois Commerce Commission On Its Own Motion -vs- Illinois Power Company	:	01-0701
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REPLY BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

Pursuant to Section 200.800 of the Rules of Practice, 83 Ill. Adm. Code 200, Staff of the Illinois Commerce Commission ("Staff" and "Commission"), by and through its attorneys, hereby submits its Reply Brief. On October 25, 2002, both Staff and Illinois Power Company ("IP", "Illinois Power" or "Company") filed Initial Briefs in this proceeding. Staff herein replies to the arguments made by the Company in its Initial Brief.[1]

I. THE COMPANY'S DECISION TO ENTER INTO TWO SWING CONTRACTS WAS IMPRUDENT

A. Contract 1

IP argues that "uncontradicted evidence" indicates that Contract 1 would have been selected using the criteria adopted by the Commission Order. (IP Initial Brief, p. 8.) Staff disagrees. Staff's Initial Brief explains why IP's assumptions regarding the criteria discussed in the Commission's Order are incorrect and will not be repeated

[1] In its Initial Brief, Staff argued that Illinois Power's decisions regarding the Freeburg Propane Plant were imprudent and necessitated an adjustment in purchased gas costs. However, in light of the Appellate Court's decision in *Illinois Power Company v. Illinois Commerce Commission*, 339 Ill. App. 3d 425 (2003), Staff is no longer advocating this adjustment.

here. (Staff Initial Brief, pp. 7-8.) However, IP also notes that Staff admitted that Mr. Peters did not make any numerical errors in his analysis (contained in his rebuttal testimony) and presumes this indicates Staff agrees with the conclusions IP reached as a result of this analysis. (Id.) Staff disagrees. Staff continued to recommend the $2,000 adjustment for Contract 1 after Mr. Peters put forth the analysis in question. (ICC Staff Exhibit 4.00, p. 2.) Staff then, as now, did not agree with the conclusions reached in Mr. Peters' analysis.

B. DMT Contract

IP argues that it should receive a credit of ($1,000) for the amount previously disallowed during the prior reconciliation period. (IP Initial Brief, pp. 9-10.) Staff disagrees. As explained in Staff's Initial Brief, IP's position regarding the DMT contract is without merit and Staff is unaware of any basis for reflecting in the instant reconciliation period an adjustment for an alleged error IP claims was made in a prior reconciliation period. (Staff Initial Brief, pp. 8-9.)

II. THE COMPANY'S DECISION TO REDUCE PEAK DAY EXPECTED DELIVERABILITY AT THE SHANGHAI STORAGE FIELD WAS IMPRUDENT

A. Industry Standards

IP flaunts the claims of its outside witness Mr. Hower who testified that IP, in his experience, exceeds what is done by most operators of aquifer storage fields elsewhere. (IP Initial Brief, pp. 16-17.) Staff disagrees with Mr. Hower's opinion. As Staff has previously argued (*See* Staff Initial Brief, p. 25), Mr. Hower's testimony is that the storage industry uses hysteresis graphs and late season flow tests on wells to monitor storage fields, but both are items that IP did not use to monitor its Shanghai Storage Field ("Shanghai"). (IP Exhibit 5.2, pp. 3-4; Tr., pp. 52-53.) Staff questions Mr.

Hower's conclusion that IP exceeded the industry standards, when it was obvious that IP failed to make use of at least two monitoring techniques that Mr. Hower admitted are used by the industry.

Mr. Hower also notes that IP had developed sophisticated tools to assist in evaluating and optimizing its Shanghai and Hillsboro Storage Fields. (IP Initial Brief, p. 17.) However, Mr. Hower indicates that that while he understood a reservoir model was implemented for the Shanghai Storage Field and that it was used as a tool to analyze the performance of the reservoir, he did not know what was done with it. (Tr., pp. 33-34.) As Staff has previously argued, IP did not refine the Shanghai model after purchasing it in 1993. (*See* Staff Initial Brief, pp. 22-23.) Mr. Hower's praise for IP is even more puzzling given that he admitted that if a reservoir model were built with an accurate geological characterization and calibrated with a sufficient database of pressure and production data, it would, with the exception of subtle or very small changes, be able to detect a reduction in the peak day capacity of a storage field. (Tr., pp. 33-34.)

Mr. Hower also noted that the company for which he is currently working had been retained to develop reservoir models for IP. (Id., p. 34.) Finally, Mr. Hower noted that he and others at his company were working on a Hillsboro Storage Field study. (Id., p. 35.) Further, Mr. Hower's surrebuttal testimony discussed the various activities that IP has performed at Shanghai over the last ten years. Each topic that Mr. Hower mentioned refers directly to Shanghai; with the exception of the following comment: "IP has conducted state of the art data collection and reservoir simulation studies to better understand the performance of their (sic) aquifer gas storage fields and to develop better field management methods." (IP Exhibit 5.2, p. 14.) Given Mr. Hower's cross-examination, the aquifer storage field he discusses had to be IP's Hillsboro Storage Field, not Shanghai.

Mr. Hower's direct testimony is even more misleading. Here Mr. Hower noted that he was hired to conduct reservoir simulation studies for both the Shanghai and Hillsboro Storage Fields. (IP Exhibit 5.0, p. 10.) Further, his testimony noted that he is currently working with IP in developing and refining new reservoir simulation models and modeling techniques to assist IP to manage and optimize the future performance of its storage fields. (Id.) Next, Mr. Hower noted that IP has developed sophisticated reservoir simulation tools to assist it in evaluating and optimizing its Shanghai and Hillsboro Storage Fields. (Id., p. 18.) Again, given his cross-examination, Mr. Hower's work was limited to Hillsboro and Staff cannot understand how he reached any conclusion regarding Shanghai. Finally, Mr. Hower noted that "[t]he data collection and reservoir modeling effort that I have personally been involved in on the Hillsboro field over the last few years is unparalleled." (Id.) Again, Mr. Hower's experience is limited specifically to Hillsboro.

Mr. Hower's conclusion that IP had developed sophisticated tools to assist in evaluating and optimizing its Shanghai storage field is even contested by the other Company witnesses. IP witness Shipp noted that, in reference to a list of projects undertaken at Shanghai, the reservoir simulator was a computer simulation model to look at withdrawal and injection scenarios for the field. (Tr., pp. 227-228.) Also, Mr. Shipp's rebuttal testimony provided a timeline of specific Shanghai enhancements that he claimed depicted that IP was proactive in its monitoring and verification process.

(Revised IP Exhibit 3.3, p. 7.) This timeline indicated that IP began the development of the Shanghai reservoir simulator model in 1993. (Id.) This same timeline failed to indicate any additional work being done on the simulator model. Further, Mr. Shipp's surrebuttal testimony indicated that the projects listed in the timeline from his rebuttal testimony are "…all of the projects done at Shanghai". (Revised IP Exhibit 3.6, p. 18.) Finally, Mr. Shipp's rebuttal testimony noted that IP's future plans include improvements to the reservoir modeling at Shanghai and Hillsboro. (Revised IP Exhibit 3.3, p. 16.)

Staff's conclusion after reviewing the above record information indicates that Mr. Hower's statement that IP had developed sophisticated tools to assist in evaluating and optimizing its Shanghai storage field is not accurate. Staff also contends that had IP fully developed the Shanghai model it would have had advanced warning of the problems it faced at its Shanghai Storage Field. If IP had refined the Shanghai model, then Staff could understand how Mr. Hower would praise IP for its actions. IP's failure to refine the model neither lends support for Mr. Hower's comments nor for IP's contention that its decisions regarding the reduction in peak day capacity at the Shanghai Storage Field were prudent.

B. Hysteresis Graphs

IP notes that Staff witness Lounsberry "did not bother to plot the graphs after he was provided (at his request) with the data to do so." (IP Initial Brief, p. 16.) Further, IP opines that if Mr. Lounsberry were so sure the plots would demonstrate his point, he would have created them and presented them as evidence. (Id.) Finally, IP notes the failure to do so speaks louder than Mr. Lounsberry's "unsupported" conclusions. (Id.)

Staff agrees that the hysteresis graphs were not plotted. However, Staff noted at the October 1, 2002, hearing that Staff had informed the Company, in response to a Company data request, that IP's diskette that contained the information necessary to plot the hysteresis graphs would not work. (Tr., p. 122.) Therefore, Staff could not make use of any of the information contained on the diskette. Also, IP had the opportunity to dispute Staff's claims by plotting the graphs with its own data, yet chose not to do so.

IP also notes it was already using numerous monitoring techniques and graphical methods to plot data similar to hysteresis graphs. IP claims that plotting the data in a different format would not reveal any hidden problems. (IP Initial Brief, p. 17.) Staff disagrees. IP notes it specifically used volume-time plots instead of hysteresis graphs. (IP Exhibit 3.3, p. 10.) A volume-time plot shows the relationship between the net gas inventory versus time. (IP Exhibit 5 at 14.) IP also notes that there are three key variables in monitoring a storage field: pressure, volume (inventory), and time. However, since there are three variables, one cannot place all of them on a two-dimensional plot, so two variables are compared to each other. (Id.) However, Staff disagrees that simply plotting volume or pressure over time replaces the value of comparing the pressure versus volume (hysteresis graph) in a storage field reservoir. Again, Staff believes the hysteresis graphs would have indicated problems at the Shanghai Storage Field prior to IP encountering the need to reduce the peak day capacity.

IP then notes that due to the metering error at Shanghai, any hysteresis plots would be incorrect and would therefore not identify the problem. (IP Initial Brief, pp. 17-18.) Staff has already refuted this argument and explained the significance of that information. (*See* Staff Initial Brief, pp. 19-20.)

C. Monitoring Wells

IP also takes issue with Staff's contention that the failure of the monitoring wells to "go to gas" should have prompted some action from IP. In particular, IP notes that the failure of the monitoring wells to "go to gas" was taken as a positive sign. (IP Initial Brief, p. 21.) IP also notes that since IP had conducted well re-perforation work and noted a resulting increase in gas saturation, the logical conclusion was that IP was doing a better job of managing its gas bubble growth and injection program and preventing gas from migrating down structure. (IP Initial Brief, footnote 15, p. 21.) Staff disagrees.

IP's logic breaks down when two facts are considered. First, IP concluded the Shanghai Storage Field well re-perforation work in 1994. (ICC Staff Exhibit 2.00, pp. 20-21.) Second, from 1995 through 1999, IP started injecting more gas at Shanghai to replace the gas lost due to a casing leak. (Revised IP Exhibit 3.3, p. 12.) Further, IP was so worried about pushing the gas off structure (movement of gas beyond the monitoring wells), it replaced the gas over a five-year period. (ICC Staff Exhibit 4.00, p. 32.) However, in the middle of the gas replacement process, the final monitoring well failed to "go to gas" (the last time a monitoring well went to gas was 1996). (Id., p. 15.) The illogical progression of events at Shanghai, specifically, the injection of more gas into the field and the resulting failure of the monitoring wells to continue to go to gas, should have caused IP to investigate problems at the Shanghai Storage Field at a much earlier date.

D. Delay in Replacing Gas at Shanghai

IP states that it saw no need to immediately replace the gas at Shanghai. (IP Initial Brief, p. 22.) Further, IP notes that this delay meant that PGA customers did not pay for the replacement cost earlier. (Id.) Staff disagrees. In fact, IP's comments regarding when IP's customers pay for the replacement gas indicates a general ignorance on IP's part of how the PGA operates. PGA customers would not pay for the replacement gas. PGA customers only pay gas costs when they make use of that gas. Therefore, IP had already received payment for the misaccounted for gas that was inadvertently sent to customers, since they are billed based upon their actual usage. The cost associated with the replacement of the gas would fall solely on IP until IP's customers had the replacement gas delivered to them. Therefore, the delay, if anything, would benefit IP's shareholders, not its ratepayers.

Next, IP disputes that the delay in replacing the misaccounted for gas at Shanghai had any subsequent impact on the problems at Shanghai, especially the sand production problems. (IP Initial Brief, p. 22.) Staff has already fully addressed the basis for its arguments regarding the various problems caused by the delay in replacing the gas at Shanghai and will not repeat those arguments herein. (*See* Staff Initial Brief, pp. 15-18.)

E. Reduction in Peak Day Capacity

IP claims that a reduction in peak day deliverability of a company-owned storage facility is not a rare event. (IP Initial Brief, p. 23.) Staff disagrees. IP's own witness, whom IP purports to be the most expert witness in the case (Id., p. 17), admitted at the hearing that he knew of no instances where a storage field operator had reduced the rated capacity of its storage field. (Tr., pp. 31-32.) Further, Staff's witness indicated that he knew of only one other instance where a utility had reduced the peak day capacity of one of its storage fields and that instance was due to the purposeful reduction in inventory at the field. (ICC Staff Exhibit 2.00, pp. 25-26.) This same witness also indicated that he reviewed the work products of the other gas section employees. (Tr., p. 90.) Therefore, Staff's witness has historical knowledge not only from his 13-year history with the Commission (ICC Staff Exhibit 2.00, p. 1), but also from the work product of other gas section employees. Obviously, the reduction in the peak day capacity of a storage field is a rare event.

IP confuses the issue by arguing data provided to the Commission by other Illinois gas utilities which indicates that two companies had fluctuations in their peak day storage expected deliverability. In particular, IP notes that information provided by Central Illinois Public Service Company ("CIPS") shows fluctuations in the peak day capacity of its storage operations. (IP Initial Brief, p. 23.) However, once IP made this claim, Staff provided CIPS' explanation for this variance. (ICC Staff Exhibit 5.00, p. 2.) Now IP contends this is not good enough and that Staff should have explained why the leased storage values were fluctuating. (IP Initial Brief, p. 23.) IP misses the point. The issue is whether IP's decisions regarding its storage fields were imprudent, not whether CIPS' were.

IP next discusses information provided to the Commission by Peoples Gas Company ("Peoples"). (Id.) In particular, IP notes that no explanation is given for why Peoples' information shows a reduction in fluctuations. (Id., pp. 23-24.) Then IP complains about Staff attempting to get into the record a document that would explain why the CIPS and Peoples information shows a reduction in storage capacity. (Id., p. 24.) IP cannot have it both ways. If IP really wanted the explanation for why the other utilities' information showed fluctuations, it would not have contested the introduction of the document. Unfortunately, such an explanation would not support IP's case and when Staff honestly explained the source of the documents, the portion of the documentation that did not relate to CIPS was not allowed into the record. (Tr., pp. 251-256.)

F. Capital Expenditures

IP notes that Staff's review of its capital and operation and maintenance expenditures for its storage fields does not reflect an apt comparison. (IP Initial Brief, p. 27.) First, IP notes that Staff's comparison of IP's budgeted capital expenditures made use of the two highest years to compare to other years. (Id.) This topic was already fully addressed by Staff and is not repeated herein. (*See* Staff Initial Brief, pp. 27-28.)

Next, IP claims that IP Exhibit 3.4 Revised indicates a pro-active level of expenditures at the storage fields. (IP Initial Brief, p. 27.) IP next notes that Staff did not make use of the information provided in IP Exhibit 3.4 Revised because it did not tie into the prior information that IP provided. (Id.) Staff agrees that it did not make use of this information. In particular, Staff notes that it encountered variances in excess of $1,000,000 between the totals associated with the individual projects that IP listed in IP Exhibit 3.4 Revised and the values shown in ICC Staff Exhibit 2.00, Schedule 2.04. (ICC Staff Exhibit 4.00, p. 27.) Since IP's capital budget averaged less than $1,000,000 for the last three years[2], making use of a document that showed a variance of an equal

[2] IP's budgeted capital expenditures for 2000-2002 average $908,000 ((760,500+1,007,500+955,000)/3). (ICC Staff Exhibit 2.00, Schedule 2.04.)

amount was not appropriate in Staff's view.

Finally, IP claims that a comparison of the data Staff collected from other utilities indicates that IP was not an unacceptable outlier with regard to its storage field expenditures. (IP Initial Brief, p. 28.) However, Staff's discussion regarding IP dealt with its level of annual capital expenditures. The information IP cites does not include this information. Therefore, IP's conclusion is invalid. Further, as IP discovered with its attempt to use the data Staff collected to discuss peak day capacities, each utility may collect or report data in a different manner. Therefore, for IP to reach any definitive conclusion from this data is ludicrous.

G. Hower testimony

IP argues that Mr. Hower was the most expert witness in the case. (IP Initial Brief, p. 17.) Staff does not agree with that broad statement but does agree that Mr. Hower possesses more storage field experience than any other Company witness. Given that, Staff does not understand why he did not take a larger role in IP's case. For instance, Mr. Hower indicated at the hearing that while he understood a reservoir model was implemented for the Shanghai Storage Field and that it was used a tool to analyze the performance of the reservoir, he did know what was done with it. (Tr., pp. 33-34.) Further, he indicated that he had not conducted any studies to determine what had caused the sanding problems at Shanghai. (Id., p. 36.) For IP to expound on Mr. Hower's qualifications and then fail to fully utilize that expertise to determine what actions should be taken at Shanghai, speaks volumes for IP's support, or lack thereof, of its past actions at Shanghai. Instead, as Staff has previously argued, IP chose to utilize as its expert witness an individual who could not even explain his prepared direct testimony at the hearing. (*See* Staff Initial Brief, pp. 30-31.)

H. Conclusion

IP attempts to confuse the issues in this proceeding by making various inflammatory comments and questioning the actions of other Illinois gas utilities. However, Staff recommends the Commission look at the facts of the case, not IP's excuses. IP has failed to explain why it is the only Illinois gas utility to reduce the peak day deliverability of its two largest storage fields. (ICC Staff Exhibit 2.00, pp. 25-27.) Additionally, during the same time frame, IP also suffered an explosion at one of those fields. Staff testified that IP's investigation into this explosion indicated that IP failed to properly investigate the root cause of the problems at Hillsboro and that was a reflection of the poor management oversight IP has for its storage fields. (Id., p. 38.) Staff believes these events are symptoms of reactive and imprudent decision making by IP with respect to its storage operations.

III. STAFF'S ADJUSTMENT FOR DELAYED PAYMENT INTEREST CHARGES IS APPROPRIATE AND SHOULD BE APPROVED BY THE COMMISSION

The Company argues that interest expense on late payments should be allowed in the PGA since it is not specifically excluded. (IP Initial Brief, p. 28) Such an argument is without merit because no cost, including interest, can be recovered through both base rates and the PGA clause. 83 Ill. Adm. Code 525 ("Part 525") established the Uniform PGA Clause in 1983 to allow utilities to adjust rates to recover gas costs without the need for frequent rate proceedings. Part 525 underwent a revision in Docket No. 94-0403 to reflect major changes, such as the rise of transportation customers and alternative gas suppliers, that had occurred in the gas industry since

1983. Although the language changed, the fact that the PGA clause is simply a surrogate for a rate proceeding did not.

With the creation of the PGA clause, certain operating expenses, "above the line" items, were allowed to be recovered on a more timely basis through the PGA clause and, concurrently, were excluded from base rates. Interest on late payments is not one of these expenses. Rather, it is a "below the line" item that shareholders are allowed to recover through the overall rate of return computation. The rate of return on investment is part of the revenue requirement recovered through a utility's base rates. Thus, the interest costs in dispute are recovered in a base rate proceeding. Therefore, if the Company is allowed to include this interest in the PGA clause, it will, in effect, be compensated twice for the same expense – once through base rates, and again through the PGA clause.

Presumably, a reasonable person familiar with the ratemaking process would not read the current Part 525 and infer that late payment fees are includable in recoverable gas costs because they are not specifically excluded from recoverable gas costs. To the contrary, a reasonable person (again, presumably) would infer that Part 525 only allows recovery of the type of interest it has specifically identified as a recoverable gas cost under the PGA clause. The fact that Staff inadvertently allowed late payment interest charges in a prior reconciliation period is no basis for allowing it in this reconciliation period. Like the Company, Staff is comprised of inherently imperfect beings who may falter in reviewing Company cost data, but that does not change the rules. Therefore, the Commission does not need to announce a new rule to which the Company must prospectively conform its actions (or inactions). (IP Initial Brief, p. 6.)

IP mischaracterizes Staff's testimony regarding the use of late payments as a financing mechanism. (Id., p. 30.) Staff never claimed that the Company routinely used late payments as a financing mechanism, only that delayed payments *could* (emphasis added) become a financing mechanism funded entirely through the PGA clause if the Company were allowed to recover late payment interest charges. (Staff Initial Brief, p. 33.) Also, Staff takes no issue with the Company's claims of imperfection or the immateriality of the interest amount at issue in this case. (IP Initial Brief, p. 30.) The $1,575 in question is only .0005% of total 2001 gas costs of $286,000,000. However, despite the immateriality of the amount, recovery through the PGA clause would send the wrong signal to all companies who use a PGA clause to recover gas costs.

Staff's adjustment to remove delayed payment interest charges from gas costs recoverable through the PGA clause is appropriate and should be approved by the Commission.

IV. IP'S ACCOUNTING ERRORS RELATED TO FRANCHISE GAS COSTS WERE ONGOING THROUGHOUT THE 2001 RECONCILIATION PERIOD

On August 23, 2003, Staff filed Direct Testimony on Reopening (ICC Staff Exhibit 6.00) to respond to supplemental testimony filed by Illinois Power concerning errors in the Company's PGA calculations related to gas costs associated with franchise requirements that resulted in an under-collection of revenues from its PGA customers for the 2001 reconcilitation year. (IP Exhibit 1.12.) Based on a review of the Company's documentation, Staff agrees that the errors were ongoing throughout the 2001 reconciliation period (ICC Staff Exhibit 6.00, p. 4) and that the revised 2001 gas costs and PGA revenues presented in IP Exhibit 1.13, Revised PGA Reconciliation for the Year Ended December 31, 2001, properly reflect corrections for the accounting errors related to franchise gas costs. (Id., p. 5.) The aforementioned revised 2001 gas costs and PGA revenues are reflected on ICC Staff Exhibit 6.00, Schedule 6.01, PGA Reconciliation Summary for the Year Ended December 31, 2001.

V. STAFF'S ADJUSTMENTS REGARDING THE FREEBURG PROPANE PLANT HAVE BEEN REMOVED

ICC Staff Exhibit 6.00, Schedule 6.01, also reflects the fact that Staff's adjustments related to the Freeburg Propane Plant have been removed based on the decision by the Illinois Appellate Court, Fifth District to reverse the Commission's finding in Docket No. 00-0714 that the Company was imprudent in its decision to retire the Freeburg facility. (Id., pp.5-6.)

VI. CONCLUSION

For the reasons set forth in Staff's Initial Brief and herein, Staff of the Illinois Commerce Commission respectfully requests that the Commission adopt Staff's recommendation to adjust Illinois Power Company's 2001 PGA reconciliation by the amount of $2,160,852. In addition, Staff requests that the Commission order the Company to implement Factor O charges of $2,003,993 for Rider A and $177,600 for Rider B Commodity, and a Factor O refund of $20,741 for Rider B Demand, as indicated in ICC Staff Exhibit 6.00, Schedule 6.01, page 1 of 4, in the first monthly PGA filing after entry of the final Order in this proceeding.

Respectfully submitted,

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